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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. ———

N. C. FREED COMPANY, INC.,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
and
THE FEDERAL TRADE COMMISSION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner,[1] N. C. Freed Company, Inc., respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this proceeding on February 1, 1973.

OPINION BELOW

The opinion of the Court of Appeals, not yet reported, appears in the Appendix, *infra*, p. 7a. The opinion of

[1] The unsuccessful appellee below, International Roofing Corporation, has been dropped as a party in these proceedings.

the District Court for the Western District of New York, which is not reported, appears in the Appendix, *infra*, p. 1a.

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on February 1, 1973 and appears in the Appendix, *infra*, p. 21a. Mr. Justice Marshall extended the time for filing the petition to June 1, 1973. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. A regulation of the Federal Reserve Board, 12 C.F.R. § 226.9(a), provides a homeowner a three-day right to rescind any credit transaction whereby a security interest is, or *will be*, retained or acquired in realty used as a residence. *Query:* whether this regulation unlawfully extends the statute, Section 125(a) of the Consumer Credit Protection Act,[2] providing rescission rights solely where such security interest *is* retained or acquired.

(a) Where the issue below centered upon the verb tense difference between the language of Section 125(a) and that of the challenged regulation, does the meaning given the words by the legislative sponsors control?

2. Whether the Federal Reserve Board, by regulation, may make subject to the civil and criminal penalties of the Act a creditor's failure to disclose the three-day right of rescission where no consensual lien is retained or acquired in the customer's home as a result of the credit transaction.

---

[2] 15 U.S.C. § 1601, *et seq.*, popularly called the Truth-in-Lending Act.

STATUTES AND REGULATIONS INVOLVED

The statute to be construed is the Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1665 (1968). The particular section to be construed is § 125(a) of the Act, 15 U.S.C. § 1635(a).

The Regulation to be construed [12 CFR § 226.9(a)] is found in Regulation Z, 12 CFR §§ 226.1-226.12 (1969), promulgated by the Federal Reserve Board.

The Act provides in pertinent part as follows: Title 15 U.S.C.—

"§ 1611. Criminal liability for willful and knowing violation

Whoever willfully and knowingly—

(1) gives false or inacurate information or fails to provide information which he is required to disclose under the provisions of this subchapter or any regulation issued thereunder,

* * * *

(3) otherwise fails to comply with any requirement imposed under this subchapter,

shall be fined not more than $5,000 or imprisoned not more than one year, or both."

"§ 1631. General requirement of disclosure

(a) Each creditor shall disclose clearly and conspicuously, in accordance with the regulations of the Board, to each person to whom consumer credit is extended and upon whom a finance charge is or may be imposed, the information required under this part."

"§ 1635. Right of recission as to certain transactions

(a) Except as otherwise provided in this section, in the case of any consumer credit transaction in which

a security interest *is* retained or acquired in any real property which is used or is expected to be used as the residence of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the disclosures required under this section and all other material disclosures required under this chapter, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so. The creditor shall clearly and conspiculously disclose, in accordance with regulations of the Board, to any obligor in a transaction subject to this section the rights of the obligor under this section. The creditor shall also provide, in accordance with regulations of the Board, an adequate opportunity to the obligor to exercise his right to rescind any transaction subject to this section. (Emphasis added)

(b) When an obligor exercises his right to rescind under subsection (a), he is not liable for any finance or other charge, and any security interest given by the obligor becomes void upon such a recission. * * *"

"§ 1640. Civil liability—Failure to disclose

(a) Except as otherwise provided in this section, any creditor who fails in connection with any consumer credit transaction to disclose to any person and information required under this part to be disclosed to that person is liable to that person in an amount equal to the sum of

(1) twice the amount of the finance charge in connection with the transaction, except that the liability under this paragraph shall not be less than $100 nor greater than $1,000; and

(2) in the case of any successful action to enforce the foregoing liability, the costs of the action together with a reasonable attorney's fee as determined by the court."

Regulation Z provides in pertinent part as follows:

"§ 226.2. Definitions and rules of construction

For the purposes of this part, unless the context indicates otherwise, the following definitions and rules of construction apply:

* * * *

(z) "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation."

"§ 226.9. Right to rescind certain transactions

(a) General Rule. Except as otherwise provided in this section, in the case of any credit transaction in which a security interest is *or will be* retained or acquired in any real property which is used or is expected to be used as the principal residence of the customer, the customer shall have the right to rescind that transaction until midnight of the third business day following the date of consummation of that transaction or the date of delivery of the disclosures required under this section and all other material disclosures required under this Part, whichever is later, by notifying the creditor by mail, telegram, or other writing of his intention to do so. * * *" (Emphasis added)

STATEMENT OF THE CASE

The action below for declaratory judgment and injunction was brought by the petitioner, a corporation in the home remodeling business, organized under the laws of the State of New York. Petitioner sought a two-part order (1) declaring invalid 12 C.F.R. § 226.9(a) which was designed to implement Section 125(a) of the Consumer Credit Protection Act (Act), 15 U.S.C. § 1635(a), on the ground that the Federal Reserve Board exceeded its Congressionally conferred authority in over-extending the reach of Section 125(a), and (2) enjoining the FTC and other federal agencies from enforcing the challenged regulation.

The facts are not in dispute. The petitioner's business was derived almost entirely from credit transactions with homeowners for the renovation and remodeling of their premises. The contracts described the materials and labor to be provided by petitioner together with the price, usually expressed in credit terms. All disclosures were made by petitioner respecting the cost of financing in accordance with the requirements of the Act.

At the time the contract was executed, the homeowner-obligor usually signed an unsecured note for the contract price of the work which, in turn, was negotiated or assigned by petitioner to a bank or other financial institution. At no time was the obligor-homeowner required or expected to execute a mortgage, deed of trust or other consensual lien on his real estate as a condition for receiving credit or for any other reason.

In credit transactions, Section 125(a) of the Act [15 U.S.C. § 1635(a)] required a creditor to furnish the obligor with a notice of his right to rescind the contract within three days where a security interest *is* retained or acquired in the obligor's residence as a condition for

the extension of credit. The challenged regulation [12 C.F.R. § 226.9(a)], on the other hand, required that all creditors inform all obligors of their rescission rights in accordance with the form contained in Appendix, *infra*, p. 24a. Such forms were required to be furnished by petitioner under the challenged regulation not only where a security interest "*is*" retained or acquired in the homeowner's residence but also where such interest "*will be*" retained or acquired *in futuro*.

The latter requirement was operative under the challenged regulation although petitioner neither retained nor acquired a consensual interest at any time in the obligor's residence and even after petitioner had waived all liens which may inur to it following completion of the work and default by the obligor.

By the broad sweep of the challenged regulation and the government's threat by criminal sanctions to enforce it, petitioner and others similarly situated are denied access to the courts to seek remedies for breach of credit contracts clearly outside the scope of rescindable transactions under Section 125(a) of the Act, but obviously within the provisions of the challenged regulation.

The petitioner suffered loss of profits and injury to its business where obligors rescinded their contracts under color of law embraced by the challenged regulation. The mere threat of criminal sanctions by the government against the petitioner and others irrespective of the outcome would adversely affect their standing in the business community.

On cross-motions for summary judgment the District Court entered judgment for the unsuccessful appellee below (petitioner here), concluding that the challenged regulation exceeded the Board's authority, stating in substance:

> "That much of the regulation pertaining to security interests that *will be* retained or acquired is beyond the Board's power and is an invalid implementation of Section 125(a).
>
> The plain fact is that Congress in enacting Section 125(a) made rescindable only those contracts which acquired a security interest through a mortgage, deed of trust, or other consensual type lien, and did not include liens which might arise in the future by operation of law." (Emphasis added) [Appendix, *infra*, p. 12a]

The Court of Appeals reversed concluding that the District Court "relied on a too technical and narrow construction which eviscerates the statute" and that the Board did not exceed its authority in promulgating the challenged regulation. *Appendix, infra*, p. 19a.

REASONS FOR GRANTING THE WRIT

Title I of the Act was enacted in 1968 "to assure a meaningful disclosure of credit terms so that a consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." 15 U.S.C. § 1601. The Act requires that certain specified disclosures to be made in all credit contracts, authorizes the Federal Reserve Board to prescribe regulations under the Act, and provides for enforcement by a variety of administrative agencies, by private litigation and criminal prosecution. The decision of the Second Circuit's erroneous conception of the Board's authority to impair the obligation of contracts between private parties in credit transactions vests the Board with legislative power beyond its Congressionally granted authority and has brought about a serious un-

certainty as to the legal obligations of thousands of debtors and creditors which only this Court can resolve.

The basic issue is whether the transactions between petitioner and its obligors are the kind of credit transactions in which the obligor's no-fault unilateral right to rescind is supported by the Act. The Court of Appeals held that the delineation of the kinds of transactions subject to rescission depends "upon the verb tense difference between the language of Section 125(a), 'is retained or acquired', and that of the regulation, 'is or will be retained or acquired'." Appendix, *infra*, p. 11a-12a. The petitioner argued successfully in the District Court that the Board "has improperly extended the reach of Section 125(a) to cover non-consensual or statutory liens arising *in futuro*, and that Congress had intended that the right of rescission . . . would pertain only to second mortgages or other consensual liens given by the homeowner at the time the contract is executed." Appendix, *infra*, p. 12a.

Arguing that Congressional intent compelled a broad sweep of Section 125(a)'s terms, the Second Circuit reversed asserting petitioner and the District Court relied upon "a hypertechnical construction of the language of Section 125(a)" and that "we fail to see how the three-day right of rescission as provided in Section 125(a) and as implemented in 12 C.F.R. § 226.9(a) can cause harm to reputable business firms." Appendix, *infra*, p. 20a. On this score the Second Circuit wandered into the field of legislation rendering a policy decision rather than interpret the ambiguous terms in Section 125(a) of the Act.

The Second Circuit argued that the challenged regulation was necessary "to effectuate the purposes of the Truth-in-Lending Act, and that Congress did not intend to restrict protection . . . solely to consensual liens, such as second mortgages, but intended to include *all*

liens resulting from consumer credit transactions." Appendix, *infra*, p. 12a. This conclusion was based on "[o]ur close reading of the legislative history." Appendix, *infra*, p. 13a.

The Second Circuit misconstrued the legislative history of the Act and ignored the weight given it by many decisions of this Court. The sponsor of the Act's amendments respecting rescission (Section 125) unequivocally stated that—

> "The amendments * * * were not intended by me * * * to apply to situations other than 'suede shoe second mortgage rocketeering operations.' Certainly there was no intent to restrict situations where a (contractor) deals directly with a homeowner and receives no security interest other than a lien arising by operation of law." [Appendix, *infra*, p. 23a]

This Court has often held that in determining the meaning of statutory words particular emphasis should be placed upon statements made by sponsors of the Act:

> "It is the sponsors that we look to when the meaning of the statutory words is in doubt." [*National Woodwork Mfg. Assn.* v. *NLRB*, 386 U.S. 612, 619 (1967)]

In the past, this Court has relied heavily on "reports of Congressional committees and explanations given on the floor of the Senate and House by those in charge of the measure." *Wright* v. *Mountain Trust Bank*, 300 U.S. 440, 463 (1937) and *Duplex Printing Press Co.* v. *Deering*, 254 U.S. 443, 475-477 (1921). A study of the legislative history set out in the Appendix, *infra*, p. 25a et seq., lends no support to the Second Circuit's sweeping contention that "Congress did not intend to restrict protection provided by the Act solely to consensual liens, such as second mortgages. . . ." [Appendix, *infra*, p. 12a] To the contrary, second mortgages were the prime target of the legislators. The Congressional Record is replete with

statements supporting the petitioner's and the District Court's contention. Appendix, *infra*, pp. 31a-35a. There was little or nothing in the legislative history to support the Second Circuit's contrary opinion.

The Board's own regulation [12 C.F.R. § 226.2(z)] defines security interest as "any interest in property which secures payment or performance of an obligation." It is universally recognized that in order to create a security interest in property the parties must, in some manner, express their intention to subject specific property to a lien or mortgage as security for the repayment of the debt. In this case neither the parties nor Section 125(a) intended that a security interest be retained or acquired in the obligor's realty. The promissory notes executed by the obligor-homeowners here retained no title nor sought to create liens. A mere note creates no security interest in property when executed or by operation of law. Its default would give rise only to an action on the note itself with no lien effect on the realty until after judgment and subsequent recording. If the Second Circuit's decision is permitted to stand, then the Federal Reserve Board may, by regulation, create security interests in realty out of the cloth of promissory notes thus overreaching Congressional prerogatives to determine what shall constitute real estate liens. The Federal Reserve Board had misgivings about the scope of Section 125(a) as late as January 3, 1972 when it recommended to Congress an amendment "to remove any uncertainty about the coverage of these transactions under Section 125(a)."[3]

The severity of the penal sanctions, fine and imprisonment, 15 U.S.C. § 1611, imposed under the Act requires a strict construction of its terms. Thus, the breadth of authority delegated to the Board under the Act, 15

[3] Federal Reserve Board Press Release, March 22, 1972, p. 13 and its Appendix C, p. 3.

U.S.C. § 1604, is read with particular stringency where criminal penalties are involved. *United States* v. *Cohen Grocery Co.* 225 U.S. 81 (1925). The Second Circuit seems to have ignored the principles upon which courts must deal with the overzealous efforts of administrative agencies to remedy what they deem to be the short-falls of Congressional enactments. The broad scope of the Board's authority to promulgate regulations, envisioned by the Second Circuit, runs counter to the principles laid down by this Court in *FCC* v. *Amer. Broadcasting Co.*, 347 U.S. 284 (1954) where the criminal aspects of an otherwise civil case were not ignored in construing the FCC Act. At 347 U.S. at p. 296 this Court observed:

> "It is true . . that these are not criminal cases, but it is a criminal statute that we must interpret. There cannot be one construction for the Federal Communications Commission and another for the Department of Justice."

Under the Second Circuit's conception of the Act, petitioner and thousands of others similarly situated face possible criminal prosecutions for alleged violations of the Board's challenged regulation whose terms, on its face, constitute an unauthorized legislative expansion of Section 125(a) rather than a clarification. The free-wheeling administrative power authorized by the Second Circuit to correct alleged Congressional oversights or omissions, unless corrected by this Court, will impress an Executive agency with legislative authority.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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June 1, 1973